



INDIANA ELECTRIC UTILITY AIR WORK GROUP

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Ms. Janet McCabe
Assistant Commissioner
Office of Air Management
Indiana Department of Environmental Management
100 North Senate Avenue
P.O. Box 6015
Indianapolis, IN 46206-6015

October 30, 2000

Re: Development of Nitrogen Oxides Budget Trading Program – 326 IAC 10-4

Dear Ms. McCabe:

The Indiana Electric Utility Air Work Group (IEUAWG), consisting of American Electric Power, Cinergy Corp, Hoosier Energy, Indianapolis Power & Light Company, Indiana-Kentucky Electric Corporation, Northern Indiana Public Service Company, State Line Energy, LLC, and Vectren Corporation appreciates this opportunity to submit comments on the proposed Nitrogen Oxides Budget Trading Program, developed in response to the U.S. EPA's NO_x SIP call and to be codified at 326 IAC 10-4. We also offer to meet with IDEM to further clarify these comments if it would be useful.

IEUAWG comments focus primarily on the practical concerns that we believe will significantly affect the implementation of the SIP call. IEUAWG members represent over 21,000 MW of fossil generation in the State or more than 90 percent of the existing NO_x SIP call affected utility generation in the State.

As a primary matter, we note that several electric generating units in the eastern portion of Indiana currently are subject to emissions control requirements under the Section 126 rule that was published by EPA on January 18, 2000. Under that rule, sources will receive allowance allocations which limit their NO_x emissions beginning May 1, 2003. The Section 126 rule will be implemented through a Federal NO_x budget trading program administered by EPA. It is certain that there will be significant differences between the Federal Section 126 program and the program ultimately adopted by IDEM in response to the NO_x SIP call. Areas of inconsistency will likely include: actual allowance allocations, length of the allocation period, allowance allocation methodology, approach to inclusion of new sources in the program, methodology for generating early reduction credits, and other aspects of the trading program. These sources will be placed in an untenable position if they are required to comply with both rules simultaneously. Accordingly, IEUAWG believes that IDEM should confirm that EPA plans to honor their previous commitment that a complying State rule in response to the NO_x SIP call would also be deemed responsive to the Section 126 petitions. IEUAWG believes that EPA should continue to honor this commitment even though the D.C. Circuit adjusted the compliance date for the SIP call to May 31, 2004. Such an approach would prevent sources from being faced with the impossible task of simultaneously complying with two significantly different federal and State programs which were enacted to achieve the same goal.

I. Trading

IEUAWG appreciates the steps IDEM has taken to develop a viable NO_x trading program to help minimize compliance costs for affected sources within the State. IEUAWG agrees with IDEM that this program can be developed by adopting EPA's model NO_x trading rule, but we recommend targeted changes to enhance the viability of the program. Moreover, IEUAWG believes that implementing a cap and trade program will be beneficial from an agency resource standpoint, in that possibly in the first year of program development, and certainly over the long term, it will take far fewer State resources to implement the NO_x trading program than it would take to implement a command and control program imposing equivalent emissions reductions.

Allowance Allocation Methodology. IEUAWG supports several key positions related to an allowance allocation methodology for electricity generating units: (1) allowance allocations should *not* be made on the basis of a single historical year's data; (2) the initial allowance allocations should be based on heat input; and (3) allowance allocations should be for more than two years.

Data for Allocating Allowances. Under the October 1998 NO_x SIP call, allowances would be allocated based on the average of the highest two years of heat input between 1995 and 1997, multiplied by 0.15 lb/mmBtu (and adjusted, as appropriate, to ensure that the budget established by EPA is not exceeded). IDEM's proposed rule incorporates this approach, although the IDEM has stated its willingness to modify this methodology to allow sources to take the average of the highest two years of heat input data between 1995 and 1999. The majority of IEUAWG members support this approach and, indeed, believe that IDEM should also expand this period to allow sources to include their 2000 ozone control period heat input, for sources that had higher heat input during this year. Such an approach ensures that all sources within the State are on relatively equal ground in terms of being able to choose which of the past six years are most representative of normal operations for purposes of allocating allowances. Moreover, there is no environmental disbenefit to this approach, as the overall emissions from the electricity generating sector remain capped at the same level no matter what heat input values are used for individual sources.

More generally, IEUAWG members agree that with the possible exception of newly-operating sources as discussed below, it is never appropriate to allocate allowances based on a single year's past operating experience. There are too many variables, such as unforeseen forced outages, which can result in a unit having non-representative low heat input for any given year. If this low heat input then determines the unit's allowance allocation in subsequent years, the unit could be unfairly penalized. Instead, IEUAWG believes that for each allocation period, a unit should be able to use the average of its highest two year's heat input during a prior five year period to determine its allowance allocation for the subsequent allocation period.¹

For new units which have begun operating and have two or less full ozone control periods of heat input data at the time allowances are allocated, IEUAWG recommends that the source be given the option either of taking its single highest ozone control period's heat input or, in the alternative, of remaining within the new source set-aside for the subsequent allocation period. Such an approach addresses the concern that in the initial year or two of operation, a new source may not have reached its full operating capacity (perhaps because it did not begin operation until the middle of the ozone control period, or because it has not yet reached optimum operating conditions or what ultimately will be its appropriate place in the dispatch order).

¹ For example, if IDEM plans to allocate allowances for the 2010 – 2014 control periods, the allocations must be made by 2007 (three years in advance), and thus would be based on the average of the highest two heat inputs for the 2002-2006 ozone periods.

Yet if a source were allocated allowances for subsequent years based on that non-representative low heat input, it could be penalized for several years to come.²

Heat Input Versus Electricity Output. All IEUAWG members agree that for the first allocation period, allowances should be allocated based on heat input. Whether or not one supports output-based allocations generally, neither the time nor the data currently exist that would allow a supportable allocation methodology based on electricity output within the time by which IDEM must finalize this rulemaking. Accordingly, the IEUAWG members universally agree that it would be inappropriate to try to allocate allowances for the first allocation period based on electricity output. Moreover, due to the complexity of the issues surrounding output-based allocations, IEUAWG agrees that it may be appropriate to include a placeholder in this rulemaking specifying that additional rulemaking will be undertaken in the future as appropriate potentially to allow alternative allocation methodologies in subsequent allocation periods.

Timing Of Allowance Allocations. EPA had originally proposed that States would submit initial allowance allocations that would apply for allocation periods of at least five years and potentially as long as ten years. 63 Fed. Reg. 25902, 25929 (May 11, 1998). The final model rule, however, provides that States would modify allowance allocations on an annual basis so long as sources have their allocations established three years prior to the control period in which those allocations would be used. 40 C.F. R. §96.41(b). IDEM has adopted this approach in its proposed rule.

IEUAWG believes, however, that this approach would have a significant adverse effect on the development of a viable trading program. Under EPA's approach, a source's allowance allocation may change from year to year based on, among other factors, changes in utilization and the number of new sources beginning operations, potentially making sources reluctant to rely on the purchase or transfer of allowances to cover their emissions because of uncertainty over how many allowances may be needed or available. This uncertainty instead may cause sources to install non-cost-effective controls instead of participating in the trading program, thereby adding to reliability concerns and the potential of increased rates for customers. Simply put, in the absence of any certainty over what future allocations will be, sources may not dare to sell allowances, nor are they likely to know how many allowances to buy.

Moreover, the Acid Rain Program experience has demonstrated that, absent highly unexpected and dramatic increases in utilization, sources will not wait until the year in which compliance is being assessed to purchase allowances; rather, sources will purchase sufficient future streams of allowances to ensure compliance. Under the frequent re-allocation approach, however, sources may be unable to purchase future streams of allowances because no one will know exactly how many allowances they will have to sell. Nor are sources likely to be comfortable purchasing large amounts of banked (prior year) allowances for future compliance because, as discussed further below, EPA's flow control provisions could result in those allowances being subject to a substantial discount that reduces their value for compliance purposes.

Issuing allowances for longer periods would increase certainty as to how many allowances sources will be able to obtain. This certainty enables utilities to devise long-term compliance strategies based on the continued availability of allowances over time, increasing the likelihood that sources will adopt market-based compliance strategies rather than simply installing controls. IEUAWG therefore recommends allocating allowances for more than two years, to enable sources to purchase sufficient future streams of allowances to

2 Indeed, if allowances are not readily available on the market, the source could be forced to continue operating at a lower level than is economically appropriate simply because its artificially low initial allocation forces the source to restrict its operations to avoid exceeding its NO_x budget.

ensure compliance, which the experience of the Acid Rain Program has demonstrated is how sources use the market for compliance purposes. Under the frequent re-allocation approach, in contrast, sources would be unable to purchase future streams of allowances because no one will know exactly how many allowances they will have to sell. IEUAWG believes that the market uncertainty created by sources being unable to determine how many allowances they will receive in the future may result in the vast majority of sources being forced to rely upon installation of controls, even if purchasing allowances would be a more cost-effective option. Thus, we are concerned that under EPA's recommended, and IDEM's proposed, approach, a viable market may not develop.

New Source Set-aside. EPA's model rule included a recommended new source set-aside. It would allocate new source allowances on a first-come, first-served basis, with any unused allowances being returned to existing sources on a pro rata basis. The Agency has stated its belief that new sources, because they are more clean-burning, should receive allocations "on the same basis as that used for existing units until the time when the new sources receive an allocation as part of an updating allocation system." 63 Fed. Reg. 57471. EPA recommends that States set-aside five percent of their allowances for 2003-2005 to cover new source emissions with a two percent set-aside for subsequent years.³ Consistent with EPA's recommendation, IDEM has proposed a five percent new source set-aside in the first allocation period, with a two percent set-aside in subsequent allocation periods. IDEM also proposes to allocate allowances on a first-come, first-served basis, with any unused allowances being returned to existing sources on a pro rata basis.

IEUAWG generally concurs that there should be some allowances provided to new sources, although we continue to have discussions over the appropriate size of the set-aside. We also recommend some important clarifications to the rule which we believe will increase certainty and enhance the viability of the new source set-aside.

First, IEUAWG recommends that new source set-aside allowances be allocated on a first-come, first-served basis, *based on the date the source is issued an approved construction permit*. We believe that this approach minimizes uncertainty for sources and also is the most fair, as those sources who get permits first likely have made the earliest initial investments and therefore should be first in line to receive allowances from the new source set-aside. Of course, if for some reason construction and ultimate operation is delayed at such a source until past the ozone control period, then the allowances that would have been allocated to the source to cover its NO_x emissions would go to the subsequent new sources. In other words, even if a source is first in line based on the date it received its construction permit, if that source has not yet begun operation in a given ozone control period, it loses its entitlement to the set-aside allowances, which pass to the source(s) that are next in line.

Second, IEUAWG agrees that because new sources are allocated allowances based on their maximum heat input (times the lower of 0.15 lb/mmBtu or their permitted emission rate), they should be required to return any unused allowances at the end of the ozone control period. However, because these units may command a portion of the new source set-aside that is significantly higher than what they actually need to operate (as such a source is unlikely to approach 100% capacity, particularly in the first few years of operation), there likely will be other new sources lower in line that do not receive any guarantee of allowances from the set-aside. IEUAWG believes that before "unused" allowances are returned to existing sources pro rata, those allowances should be allocated to any new sources that were too low in line to receive a guarantee of allowances from the set-aside. Such an approach more accurately reflects the purpose of the set-aside (*i.e.*, to ensure that new sources have sufficient allowances to operate until such a time as they can be fully

3 EPA emphasizes, however, that States may address new sources in any way that they choose so long as emissions from those new sources are subject to the overall State budget.

integrated into the allowance program). As a practical matter, it may be necessary to require new sources that initially receive allowances from the set-aside to have an expedited “true up” period so that the lower in line new sources will know whether they will receive any allowances from the set-aside before the allowance surrender deadline.

Third, if IDEM adopts an allowance allocation period that is longer than two years, IEUAWG believes that the new source set-aside should adopt a methodology to incorporate new sources into the allowance system before allowances are re-allocated. Specifically, once a source has been operating for two ozone control periods, that source should receive a fixed allocation for the allocation period based on the highest heat input of those two ozone control periods, multiplied by the lower of 0.15 lb/mmBtu or the source’s permitted emission limit. Those allowances allocated to the source would be “retired” from the new source set-aside and, to the extent the source emits less than its allocation, that source would not be required to return unused allowances to the set-aside. This approach not only integrates new sources into the allowance program rapidly, but also provides additional certainty to new sources that are lower in line for set-aside allowances. (That is, because set-aside allowances initially are granted to sources based on their maximum heat input, granting a fixed allocation for the allocation period to these sources makes it more likely that lower in line sources will receive a guarantee of allowances through the set-aside.)

II. Size of the Compliance Supplement Pool – Addressing Reliability Concerns

During the SIP call rulemaking, concerns were raised that sources may have difficulty installing controls by the May 1, 2003 compliance date (now May 31, 2004) and that the need for so many electricity generating units to install SCR technology could adversely impact the reliability of the electric utility supply. To address these concerns EPA created a “compliance supplement pool.” 40 C.F.R. § 51.121(e)(3). The compliance supplement pool consists of 200,000 tons for the entire 22 State region, and will be distributed among States in proportion to the size of the emissions reductions they are required to achieve under the SIP call. 40 C.F.R. §51.121(e)(3)(iii). Indiana will receive 19,915 compliance supplement pool allowances based on EPA’s calculation of how many SCR’s will be needed in the State to meet the 0.15 lb/mmBtu limit. States can either: (1) use the pool to issue early reduction credits to sources that control NO_x emissions before the May 31, 2004 compliance deadline (which credits may be traded or sold to sources that need them to cover excess emissions); and/or (2) distribute the credits directly to sources needing a compliance extension.

In order to assure that the compliance supplement pool would be no larger than necessary to address reliability and hardship concerns, the Agency estimated the number of SCRs (and SNCRs) that it believed would be installed to comply with the SIP call.⁴ EPA further assumed that 33 percent of the SCR capacity would be installed in each of the years 2001, 2002 and 2003. The Agency then calculated how many excess emissions would need to be offset if installation of 33 percent of the total SCR capacity were delayed by one year. EPA estimated this number to be 200,000 tons, which then became the size of the final compliance supplement pool.⁵

As a preliminary matter, IEUAWG notes that the modified compliance deadline established by the D.C. Circuit (May 31, 2004 rather than May 1, 2003) cannot properly be considered an extension of the compliance deadline because the Court’s order did nothing more than preserve the status quo as it was before

4 Because significantly less time is necessary for installation of SNCR, EPA assumed that additional outages would not be needed and reliability concerns would not be implicated for sources installing SNCR.

5 See 63 Fed. Reg. 57356, 57428-57429 (Oct. 21, 1998).

May 1999 when the D.C. Circuit stayed the SIP submittal deadline. IEUAWG believed in 1999 and continues to believe that the size of the compliance supplement pool is insufficient to address some significant reliability concerns, particularly in Indiana and other Midwest States. IEUAWG therefore recommends that IDEM double the size of the pool. In addition to addressing reliability issues, this approach would have a significant environmental benefit and would enhance the viability of the NO_x trading program.

Electricity Reliability. Electric system reliability is of great concern to the Indiana electric utilities. The Indiana utilities spend considerable resources each year maintaining their generating units and their transmission and distribution system so that they can reliably deliver electricity to their customers. Customers depend on electricity for many of the benefits and necessities of daily life and for the health of the economy. During 1967, a series of massive black outs instigated the formation of ten regional electric reliability councils across the United States. These councils work with member utilities to maintain reliability.

The electric distribution grid is designed to prevent power outages when generating units go off line. It depends on having sufficient generating and transmission capacity available in reserve to protect the electric grid when generation or transmission capability within the region is lost due to weather, forced outages or other reasons. Individual utilities within the region need to have sufficient generation and transmission capacity available at all times. They do this using a number of mechanisms such as advance planning of normal unit maintenance outages, or making arrangements with other utilities to purchase and transport power, if possible. Scheduled outages are usually planned for periods of less customer demand, typically in the spring and fall of the year when weather conditions require less electricity demand for heating and air conditioning.

In its NO_x SIP call rule, EPA assumed that a certain mixture of control technologies would be applied by electric generating units (EGUs) to achieve the emission reductions needed to meet the State NO_x budget. EPA used cost and schedule estimates that employed a high percentage of SNCR technology to bolster their position that the electric utilities could cost-effectively achieve the required emissions reductions needed to reduce NO_x transport. Specifically, according to the Agency's analysis, only approximately 35% of the generating capacity in the SIP call region would install SCR.⁶

The Utility Air Regulatory Group (UARG) commissioned studies by Zinder, Cichanowicz and Applied Economic Research (AER) to investigate these assumptions and verify EPA's conclusions.⁷ The results of these studies showed that SCR would be needed in much higher proportions than EPA anticipated. It also showed that the installation of this technology would be more time consuming and costly than EPA anticipated. These discrepancies are attributable to shortcomings in EPA's assumptions as discovered by utilities in their compliance planning work.

Specifically, Zinder and Cichanowicz estimated that about 68% of the generating capacity in the 22 State region will need to install SCR to meet the 0.15 lb/mmBtu limit. Studies by the East Central Area Reliability Council (ECAR), which includes all of Indiana, confirm this conclusion, as does IDEM's own analysis of the types of controls needed to meet the NO_x SIP call. Indeed, IDEM's recent study in association with the SUFG calculated that 40 SCRs are necessary in Indiana to meet a 0.15 lb/mmBtu emission level by 2004. Installing this large amount of control technology in a very short time will decrease

6 EPA, *Feasibility of Installing NO_x Control Technology by May 2003*, p.3, Exhibit 1 (Sept. 1998).

7 These comments support and incorporate by reference the results of the Zinder, Cichanowicz and AER report. This report previously was submitted to IDEM in Cinergy's Comments on IDEM's First Notice for Development of New Rules Concerning Emissions of Nitrogen Oxides, dated December 1, 1998. IEUAWG would be happy to provide an additional copy of the report upon request.

reliability and increase the possibility of disruptions in the supply of electricity. Based on the reserve capacity cited in the AER study and the prediction that the amount of available reserve will be below acceptable margins of safety, disruptions to the power supply of between approximately 500 to 800 hours per year across the region are predicted by AER. The assumptions in the AER study do not consider a greater than expected number of EGUs or transmission lines out of service due to storm damage or NRC limitations, as we saw in the summer of 1998. The AER study also does not consider the possibility of EGUs being forced to not operate because they are unable to install the required control device or obtain allowances (due to the stringency of the hardship demonstration requirements) by the compliance deadline, which would further limit available electric supply.

To help prevent disruption to the electric supply, we recommend that IDEM double the size of the compliance supplement pool. Such an action is appropriate given the purpose of the compliance supplement pool – which was to provide approximately one-third of the units installing SCR the flexibility to defer installation by one year – and the fact that the number of SCRs to be installed is approximately double what EPA predicted. Moreover, doing so will not only address reliability concerns, but also provide an air quality benefit that would be lost under EPA's overly restrictive limits on the ability to generate early reduction credits.

EPA's Approach Results In Lost Air Quality Benefits. The number of allowances available for distribution as early reduction credits from EPA's compliance supplement pool is substantially smaller than the number of credits that could be generated by sources installing SCR or other control technology between 2001 and 2003. We expect that sources will stagger the plant outages required for SCR installation over the three-year period preceding the May 2004 SIP call compliance deadline. Those units which pose the least costly compliance challenges would probably be retrofitted with SCRs first. Thus, a considerable number of SCRs should be ready to begin operations before the 2004 deadline. Because they will not receive early reduction credits, however, many sources that will have installed SCRs prior to 2004 simply will have no incentive to incur the substantial costs of loading catalyst (which is quite expensive) and operating controls before May 2004. Thus, as a result of EPA's limitations on the availability of ERCs, substantial early emissions reductions that are both feasible and achievable will not occur.

These lost emissions reductions translate into a potential lost air quality benefit. Any reductions in emissions that occur prior to 2004 could improve air quality in the areas where they occur and in downwind areas. As an environmental policy matter, therefore, early reductions should not be discouraged. Indeed, EPA has publicly touted the success of the Acid Rain Program as inducing a large number of sources to comply early, reducing emissions in Phase I of the Program far below what was mandated by the statute. Yet EPA's limitation in the SIP call on the generation of ERCs actually discourages such early emissions reductions because sources will have no incentive to incur the additional costs of loading catalyst and operating SCRs before they are legally required to do so. Calculations by IEUAWG members indicate that the entire compliance supplement pool allocated to Indiana could potentially be consumed by the installation of SCR at one power plant. This is a result of EPA's miscalculation of how many SCR's would be necessary in Indiana. Estimates by IEUAWG indicate that it is likely that more than twice as many SCR's will be required in Indiana to meet 0.15 lb/mmBtu limit than EPA estimated. Therefore, the size of the compliance supplement pool for Indiana is grossly underestimated.

EPA estimates that Indiana EGU baseline NO_x emissions between 2001 and 2003 are 136,773 tons per ozone control period and after application of the 2003 NO_x budget 47,731 tons per ozone control period. Therefore, between 2001 and 2003 a potential NO_x reduction of up to 267,126 tons is available.⁸ The

8 (136,773 tons allowable per year – 47,731 tons per year EGU SIP call cap) x 3 years (2001, 2002 and 2003 – the

EPA compliance supplement pool limits early reductions credits to a total of 19,915 tons prior to 2004. Therefore, sources are only encourage to reduce their emission up to 19,915, not the full potential 267,126 tons, or only 7 percent (19,915/267,126) of the potential NO_x reductions prior to 2004.

EPA's Approach Hinders Development of Trading Program and Increases Costs of Compliance without Commensurate Air Quality Benefits. The limitation on generation of ERCs, which is capped at the level of the State's compliance supplement pool, makes ERC generation a risky compliance strategy. Ideally, sources that begin operating SCRs before 2004 would use the resulting early reduction credits to phase in controls on more complex units after May 2004 or to reduce compliance costs by selling these credits to other sources. However, the limited number of ERCs that will be available under the compliance supplement pool may be far smaller than the additional allowances that could be generated by the early implementation of controls. Moreover, a company may not know until just before the 2004 ozone control period whether or not it will actually receive the allowances it counted on for its compliance strategy (because the limited allowances available must be divided up among the sources who reduced emissions early or requested compliance extensions). Thus, the source may belatedly receive fewer allowances than anticipated if the pool is oversubscribed, exposing it to the risk of non-compliance unless it is successful in obtaining additional allowances that may or may not be available for purchase on the market.⁹

The limited number of ERCs and the uncertainty whether they will be available, coupled with overall doubts about whether a viable NO_x market will develop, will greatly reduce the attractiveness of ERC generation as a compliance strategy. Faced with these risks, companies are likely to attempt to follow the conservative path of working to install controls on all needed units by May 2004 rather than attempt to reduce costs by selling early reduction credits to other sources or using these credits to defer installation of controls on selected units that pose complex engineering challenges or face other environmental requirements. According to EPA's estimates, compliance with the SIP call in the absence of a trading program will increase costs by \$500 million per year. Without a sound ERC mechanism, incentives for allowance trading will be greatly reduced, depriving sources of the ability to implement a phased, cost-effective implementation strategy based on the availability of credits either from within their own systems or in the marketplace.

IEUAWG's approach, in contrast, addresses reliability concerns and provides additional incentives for early reductions—with concurrent benefits to the environment—and recognizes that generation of ERCs can provide opportunities to delay installation of controls at selected sites while at the same time providing early air quality benefits and stimulating development of a viable allowance market.

As an alternative, IDEM should consider an approach that the State of Ohio is currently planning to include in their State rule to respond to the NO_x SIP call. Under this approach, Ohio EPA is planning to distribute a block of additional allowances in 2004 equal to one fifth of the total baseline EGU NO_x emissions that would occur during the ozone control period (May 1 through September 30). This block of additional allowances will be equivalent to the total actual baseline EGU NO_x emissions that would occur between May 1 and May 30, 2004. These allowances will be in addition to the allowances issued under the State budget for the period May 31 through September 30, 2004. Under this approach, affected EGUs in Ohio will be required to report NO_x emissions for the entire ozone control period (May 1 through September 30) during 2004, even though the D.C. Circuit Court adjusted the compliance date for the NO_x SIP call to May

three years in which early compliance could occur) = 267,126 tons.

9 That addition of a year or two before compliance would be required is critical to permitting the NO_x allowance market to develop. Specifically, once a source knows it has an additional year or so before control technologies must be installed, the source then can evaluate whether a market is developing and allowances are becoming available such that allowance trading may be a viable strategy for the longer term.

31, 2004. If an affected EGU elects to control NO_x emissions during the entire ozone control period (May 1 through September 30) in 2004 and not exceed allowances received under the State budget, the EGU will be able to bank the additional allowances for future unrestricted use or sale. If an effected EGU elects not to control during the period May 1 through May 30, 2004, the EGU still has to report these emissions and the additional allowances issued from this additional block of allowances will be used to cover the uncontrolled emissions for this period (May 1 through May 31, 2004). Under this approach, no additional allowances are created over and above the State budget because the additional allowances that are made available to the effected EGUs during 2004 are equal to the NO_x emissions that would have actually been emitted by the effected EGUs if they did not elect to control between May 1 and May 31. These additional allowances would be separate from and in addition to the allowances in the compliance supplement pool.

III. Allocation of Allowances from the Compliance Supplement Pool

IEUAWG makes the following recommendations for how IDEM should allocate the allowances from the compliance supplement pool: (1) compliance supplement pool allowances should expire at the end of the 2005 ozone control period and should be exempt from flow control; (2) as proposed by IDEM, sources should be eligible to receive ERCs for reductions made below their most stringent existing permit limit (generally, their Title IV limit) between 2001 and 2003; and (3) as explained further below, sources should be eligible to earn ERCs on a pro rata basis, as determined by their contribution to the total heat input in the State.

Allow sources to use compliance supplement pool allowances for compliance in the 2004 and 2005 ozone control periods and exempt these allowances from flow control. Under EPA's final NO_x SIP call, sources could use allowances from the compliance supplement pool for the first two years of the program. After the 2004 ozone control period, however, any unused compliance supplement pool allowances would expire. The D.C. Circuit recently changed the SIP call compliance deadline from May 1, 2003 to May 31, 2004. To retain the intent of the original rule – which was to allow sources to use compliance supplement pool allowances for the first two ozone control periods – the expiration date for compliance supplement pool allowances also should be extended by one year. IEUAWG therefore supports IDEM's proposed approach of allowing compliance supplement pool allowances to be used in the 2004 and 2005 ozone control periods. However, to make these allowances fully useable for their intended purpose, compliance supplement pool allowances should be exempt from flow control.

Allow sources to generate credits for any reductions below their most stringent current NO_x emission limit (under Title IV or other programs) between 2001 and 2003. EPA's model rule would limit generation of ERCs to emissions reduced below 80% of the source's baseline and 0.25 lb/mmBtu. However, this feature of the model rule is optional and States are free to pursue a different approach.

The size of the compliance supplement pool allocated to each State was based on the amount of emissions reductions required in that State. In so doing, EPA recognized that those companies making the most significant emissions reductions would face the greatest costs and would most be in need of allowances to delay installation of controls at one or more units. Allowing ERC generation only for reductions below 80 percent of a source's baseline and 0.25 lb/mmBtu, however, would be contrary to this objective by disallowing credits to sources who make the most substantial emissions reductions in response to the SIP call.

The IEUAWG members, with the exception of one member who has already offered comments in opposition to this approach, therefore concur with IDEM's proposed approach of allowing early reduction credit for any emissions reductions below a source's most stringent current emissions limitation, relying on the allocation methodology described below to provide sources certainty in allocations and to cap

each source's ERC allocation in the event of compliance supplement pool oversubscription. IEUAWG also agrees with IDEM that because the compliance deadline is now May 31, 2004, sources should be able to obtain early reduction credit for emissions reductions made in 2003.

Conduct a preliminary, advance allocation of ERCs based on each source's contribution to total heat input in the State. The IEUAWG members, with the exception of one member who has already offered comments in opposition to this approach, believe that by conducting a preliminary, *pro rata* allocation of ERCs as soon as possible, Indiana can provide companies who pursue the early reduction option with compliance certainty and enable them to stagger SCR construction before and after the May 2004 compliance date. In the IDEM rule, ERCs should be preliminarily allocated to companies based on their percentage contribution to the total heat input in the State (*e.g.*, a company responsible for 20% of the heat input in the State would be eligible to earn 20% of the allowances in the compliance supplement pool). Using heat input to allocate ERCs is fair because it will correspond to IDEM's overall methodology for allowance allocations and will give companies the opportunity to earn ERCs roughly commensurate with the proportionate level of emissions reductions they are required to make.

Under this approach, companies would be eligible to earn ERCs up to their preliminary allocation. If a company did not generate sufficient ERCs to utilize its preliminary allocation, the remaining, unearned ERCs would revert to the general State pool, to be reallocated on a *pro rata* basis to the other companies in Indiana who have generated more ERCs than their preliminary allocations.

EPA has given States latitude on how to reallocate ERCs if the pool is oversubscribed but has identified two options for States to consider: (1) issue ERCs on a first-come, first-served basis; or (2) once all facilities have submitted their ERC requests, allocate ERCs on a *pro rata* basis, discounting all early reductions generated by an equal amount, so that the total number of ERCs does not exceed the number in the compliance supplement pool. The uncertainty engendered by these options would prevent sources from relying on the generation of ERCs to delay installation of controls at one or more units. Specifically, companies will have no way of knowing before the end of 2002 at the earliest, and more probably late 2003, whether or not they will be able to obtain sufficient allowances to delay installation of controls at one or more units. However, the need to coordinate construction outages, coupled with shortages in craft labor, structural steel and ductwork, as well as catalyst, mean that if a company delayed planning SCR construction until that time, it likely would be unable to comply. As a result, using either allocation approach recommended by EPA, companies will necessarily have to assume that they cannot delay control installation at any units; in this event, the compliance supplement pool will not serve the purpose for which it was intended.

In contrast, the IEUAWG members, with the exception of one member who has already offered comments in opposition to this approach, believe that a preliminary allocation of the State's pool based on each source's relative heat input would provide sources with certainty about the *minimum* number of ERCs they are eligible to receive; if other sources do not generate ERCs up to their preliminary allocation, a company could earn more ERCs but its preliminary allocation could not be reduced (unless the company fails to make the early reductions and therefore fails to earn the ERCs). Coupled with an assessment of how many ERCs they can generate and how many they will need to delay installation of controls at one or more units, this approach will enable companies to use the compliance supplement pool for the purpose for which it was intended.

Such an approach also is consistent with how the industry addressed the Phase I compliance extension provisions of the Acid Rain Program. There, the statute created a limited pool of allowances to be allocated in 1995 and 1996 for Phase I affected units which planned to install scrubbers. Based on a statutory requirement, the allowances were allocated on a combined first-come, first-served and lottery basis (for applications received on the same day). 40 C.F.R. § 72.42(b), (d). The industry, however, was concerned

that some companies would receive all of the allowances they needed while others would receive nothing. They therefore entered into a private contractual agreement which allocated allowances *pro rata* to each source that planned to install scrubbers, with a small bonus of allowances for those sources that “won” the lottery. Accordingly, each company knew (with a small margin of error) how many allowances they would receive, long before the compliance deadline. In addition, companies knew that the allowances they would receive would be roughly proportionate to the control expenditures they had planned.

IV. Energy Efficiency and Renewable Energy Set-Aside in the NO_x Budget Trading Program

The U.S. EPA has issued guidance advocating that States withhold NO_x emission allowances from affected EGUs subject to the NO_x SIP call to give to persons who implement approved energy efficiency or renewable energy projects as an incentive to implement such projects, and IDEM has requested comments on whether such a set-aside should be included within the NO_x Budget Trading Program. The majority of IEUAWG members oppose inclusion of such a set-aside in the Indiana response to EPA’s SIP call¹⁰. As an initial matter, it should be noted that the adoption of the set-aside would not improve the air quality, and is not mandated as a part of the NO_x SIP call. As a result, the imposition of a set-aside on the electric generating units within a State would represent a restraint more stringent than the already extremely stringent emissions reduction requirements of the SIP call.

Unless there is certainty that at least the same number of allowances will be returned to the trading system as were withheld in a given year, use of such a set-aside represents a net decrease in the overall trading budget which will create a still more stringent emission limit. Coupled with the new source set-asides which have been proposed, the emissions cap will effectively be up to 20% more stringent, equating to an effective emissions limit of approximately 0.12 lb/mmBtu times the baseline heat input. Creation of an energy efficiency reserve will therefore require installation of additional controls, raise the EGUs compliance costs, and further reduce the benefits of allowance trading. Reliability issues, discussed previously, would be compounded by the increased stringency of the emission limits.

EPA claims that the renewables set-aside is a mechanism that will reduce the overall cost of compliance with the very stringent NO_x SIP call budgets. However, EPA’s guidance overstates the benefits and understates the costs of such a program. In addition, it introduces an unacceptable level of uncertainty to compliance planning which will result in less cost-effective over-compliance by EGUs. As a result, the effect of such a reserve will be to increase the overall cost to EGUs and the economy with little or no commensurate environmental benefits.

EPA is encouraging State environmental agencies to go beyond their mandate by setting energy policy without the participation of utility regulatory commissions and other agencies charged with establishing and implementing energy policy within a State. Its analysis fails to take into consideration a broader range of issues, and seems to rely solely on the assertion that conservation and renewables are always better than fossil generation regardless of cost. This assumed preeminence of conservation and renewables oversimplifies the broad range of factors that should be considered in adopting energy policies.

Thus, the majority of IEUAWG members believe that Indiana should not adopt energy efficiency/renewable energy incentives as a part of the NO_x SIP call for the following reasons: (1) setting allowances aside for energy efficiency and renewable energy projects will increase uncertainty and raise

10 NIPSCO believes that a program rewarding the development of efficient technologies and renewable energy sources without disadvantaging EGUs is possible in the context of this rulemaking.

electricity generator compliance costs; (2) the approach advocated by EPA would seek to continue mandatory utility-funded demand side management programs and impose an unfair, indirect tax on customers; (3) the treatment of “free riders” ensures windfalls to projects that will be implemented anyway because of their overall cost-effectiveness, but is not a cost-effective means to provide incentives to new projects designed to further EPA’s air quality goals; (4) many customers may see bill increases as a result of the set-aside; (5) requiring existing and future fossil-fired generators to subsidize current and future competitors is unfair; (6) the proposal is too vague about the allocation of set-aside allowances to be adopted; (7) EPA has overstated the level of participation which can reasonable be assumed in the set-aside pool; (8) record keeping obligations will deter participation; and (9) EPA’s guidance projects outrageously ambitious growth of non-hydro renewable supply resources.¹¹ If IDEM disagrees, however, and chooses to establish an energy efficiency and renewables set-aside, the allowances to fund that set-aside should not be taken from the electricity generating unit budget because doing so would unfairly lower the already stringent emissions rate to which electricity generators are subject, thereby increasing costs above what was considered “highly cost-effective” (and therefore required) in the final SIP call.

V. Opt-Ins

EPA’s model rule contains an optional section, Subpart I, which can be adopted if a State chooses to allow non-subject sources to “opt-in” to the NO_x budget trading program.¹² To be approvable, the SIP must adopt EPA’s opt-in provisions; the State is not free to develop its own opt-in program. To be eligible to opt-in, a source must: (1) have an authorized account representative who can buy, sell or trade allowances and certify compliance on behalf of all of the owners and operators of the source; and (2) be able to monitor its emissions in accordance with Part 96, Subpart H (*i.e.*, is able to monitor emissions with sufficient accuracy to ensure that the integrity of the program is maintained). In that regard, opt-in sources (as well as other sources subject to the trading rule) generally will be required to install and operate CEMs.

In general, the broader the coverage of the trading program, the more likely it is that a viable market will develop. That is, there will be more sources with potential opportunities to reduce emissions, generating allowances for sale. IEUAWG therefore supports development of as broad-based a trading program as possible. Accordingly, we believe that inclusion of an opt-in program can provide significant benefits for the market. Specifically, an opt-in program can expand the scope of program coverage, thus enhancing market viability by increasing the number of market participants. In addition, sources generally will opt-in to the program because they plan to reduce emissions and generate allowances for sale; there would be little benefit to opting in if a source were simply going to comply on a source-specific basis, or if a source would not have sufficient allowances to comply. Thus, an opt-in program not only increases the number of market participants; it increases the number of *active* market participants. IEUAWG therefore believes that inclusion of an opt-in program for sources that currently are not in the NO_x Budget Trading Program would be beneficial for promoting a viable market in Indiana.

11 These issues have been discussed at length in prior comments submitted by IEUAWG. We would be happy to provide an additional copy of these comments, on request.

12 If a State allows opt-ins, its budget for purposes of the trading program will be revised to reflect the opt-in source’s emissions.

Ms. Janet McCabe
October 30, 2000
Page 13

The IEUAWG appreciates this opportunity to comment on this rulemaking. If you have any questions on these comments, please contact me at (614)-223-1245.

Sincerely,

David J. Long
Chair

cc: IEUAWG Members

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